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BEFORE THE ARIZONA CORPORATION COMMISSION

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GARY PIERCE, Chairman
SANDRA D. KENNEDY
PAUL NEWMAN
BOB STUMP
BRENDA BURNS

AZ CORP COMMISSION
DOCKET CONTROL

IN THE MATTER OF THE APPLICATION
OF CHINO MEADOWS II WATER CO., INC.
FOR A RATE INCREASE.

DOCKET NO. W-02370A-10-0519

REJOINDER TESTIMONY

Chino Meadows II Water Co., Inc. ("Chino Meadows") hereby files its rejoinder testimony in the above-captioned case.

Respectfully submitted on September 29, 2011, by:

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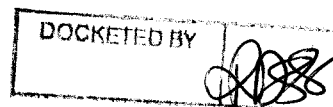
Docket Control
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

By:

Craig A. Marks

Arizona Corporation Commission
DOCKETED

SEP 29 2011



BEFORE THE ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF THE APPLICATION OF
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**REJOINDER TESTIMONY
OF
RAY L. JONES
ON BEHALF OF
CHINO MEADOWS II WATER CO., INC.
SEPTEMBER 28, 2011**

**REJOINDER TESTIMONY
OF
RAY L. JONES
ON BEHALF OF
CHINO MEADOWS II WATER CO., INC.
SEPTEMBER 7, 2011**

TABLE OF CONTENTS

I	INTRODUCTION AND QUALIFICATIONS	1
II	RESPONSE TO STAFF'S SURREBUTTAL TESTIMONY	1
III	USE OF OPERATING MARGIN	4
IV	RATE BASE	8
V	INCOME STATEMENT	8
VI	OTHER ISSUES	11
VII	RATE DESIGN	11

I INTRODUCTION AND QUALIFICATIONS

Q. PLEASE STATE YOUR NAME AND ADDRESS?

A. My name is Ray L. Jones. My business address is 25213 N. 49th Drive, Phoenix, Arizona 85083.

Q. ARE YOU THE SAME RAY L. JONES WHO PREVIOUSLY SUBMITTED DIRECT AND REBUTTAL TESTIMONY IN THIS DOCKET?

A. Yes.

II RESPONSE TO STAFF'S SURREBUTTAL TESTIMONY

Q. HAVE YOU REVIEWED STAFF'S SURREBUTTAL TESTIMONY IN THIS CASE?

A. Yes, I reviewed the testimony provided by Juan C. Manrique and Crystal S. Brown.

Q. WHAT WAS YOUR INITIAL REACTION TO STAFF'S SURREBUTTAL TESTIMONY?

A. I was disappointed. I had hoped that Staff would respond more positively to the ideas discussed and compromises proposed in my Rebuttal Testimony.

Q. WHY DID YOU THINK STAFF WOULD RESPOND MORE POSITIVELY TO CHINO?

A. I have been encouraged by the Commission's recent discussions regarding the financial issues facing water companies, both large and small.

The Commission has recently opened two dockets related to addressing issues facing water companies. Docket ACC-00000A-10-0466 was opened to addressing regulatory lag faced by water companies and other utilities. Additionally the Commission opened Docket W-00000C-06-0149 to several issues facing water companies.

1 The Commission recently completed workshops (Docket No. W-00000C-06-0149)
2 addressing many issues facing water companies. At the initial workshop meeting,
3 Utilities Director, Steve Olea, asked the participants to think outside of the box and stated
4 that water is too cheap. Others spoke to the plight of small water companies, in particular
5 mentioning the need for consolidation of companies and the need to enhance viability of
6 water companies and encourage investment in infrastructure. Commissioner Mayes
7 observed: We must deal with small water companies. They take all the time. They are
8 troubled. They are the elephant in the room.

9 As the workshops progressed, the original scope of the docket was expanded and many
10 topics were discussed. I thought the discussions were productive and indicated a
11 willingness by the Commission to begin taking action to address issues facing small
12 water companies such as Chino.

13 I felt this case was a good opportunity to address some of the issues facing a small water
14 company such as Chino. Chino is a company working hard to address issues and
15 improve its operations. Chino is requesting a modest rate increase and has not had a rate
16 increase in over 16 years. Chino needs sufficient revenue to continue its improvements
17 and attract new investment into its water system. This case appeared to me to be a good
18 opportunity for the Commission to break from its past practices and move to a style of
19 ratemaking that addresses some of the problems facing small utilities.

20 **Q. HOW WOULD YOU DESCRIBE STAFF'S APPROACH TO ITS**
21 **SURREBUTTAL TESTIMONY?**

22 A. Their approach is consistent with its Direct Testimony and consistent with practices I
23 have observed on other past cases. I would describe it as a minimalistic approach to
24 setting a revenue requirement. The approach seems to have the goal of arriving at the
25 lowest supportable revenue requirement. My observation is that this approach was

1 developed over many years of customer-centric rate case processing at the Commission.

2 While I understand that a low revenue requirement benefits customers, we are now seeing
3 the results of focusing just on low revenue requirements. Small Arizona water utilities
4 are clearly struggling.

5 One clear lesson of the workshops is that customers also benefit from a financially
6 healthy utility that can attract capital and address customers' needs.

7 **Q. WOULD YOU SUMMARIZE THE DIFFERENCES BETWEEN YOUR**
8 **POSITION AND STAFF'S?**

9 A. It appears that our differences come down to two basic issues¹. We have a fundamental
10 disagreement about whether to use rate of return to set the revenue requirement as
11 recommended by Staff, or whether to use an operating margin to set the revenue
12 requirement as recommended by Chino. This disagreement impacts the revenue
13 requirement by approximately \$42,000. The operating margin issue is discussed in detail
14 below.

15 We also disagree on the level of expenses to include in the test year. The difference is
16 approximately \$36,825. The difference is not so much a disagreement on the facts as it is
17 a disagreement on our approaches to rate making.

18 **Q. WHAT IS CHINO'S REJOINDER REVENUE REQUIREMENT?**

19 A. Chino's rejoinder revenue requirement is shown on Schedule RLJ-1. Chino's requested
20 revenue increase is \$64,305, an increase of 18.29% over adjusted test-year revenues of
21 \$351,633.

22

¹ As of the preparation of this Rejoinder Testimony, Staff had not filed schedules supporting its Surrebuttal Position. Accordingly, estimates of Staff's positions are used in this analysis. I believe that Staff and the Company either agree or are very close to agreement on ratebase.

III USE OF OPERATING MARGIN

**Q. HOW WAS CHINO'S REJOINDER REVENUE REQUIREMENT
DETERMINED?**

A. As shown on Schedule RLJ-1, the revenue requirement is calculated to produce an
operating margin of 12.5%

**Q. WOULD YOU SUMMARIZE YOUR POSITION REGARDING USE OF THE
OPERATING MARGIN METHOD?**

A. As fully discussed in my Rebuttal testimony, there were several factors that led to the
decision to use the operating margin method.

- Chino is a small company with a relatively small rate base and rate base per customer. A company operating at a small margin may have difficulty covering increasing or fluctuating costs, dealing with contingencies, and attracting new capital for system improvements.
- Chino is concerned that setting rates based on the rate base method will not provide sufficient income to allow Chino to attract sufficient funds to complete needed system improvements.
- Chino has a history of fluctuating costs that are not being recovered in the allowed expenses in this case. Chino must have sufficient revenues to cover these fluctuating expenses while still being able to deal with increasing costs and capital investment needs.

Q. HAS CHINO COMPARED THE OPERATING MARGIN RESULTING FROM STAFF'S RECOMMENDED REVENUE REQUIREMENT TO OTHER COMPANIES RECENTLY IN THE RATE MAKING PROCESS?

A. As fully discussed in my Rebuttal Testimony, I compared the proposed Chino revenue requirements to the revenue requirement recently approved for Chino's sister company Granite Mountain Water Co., Inc. ("Granite"). As shown in the table below, both the current Staff position and the Company's calculation of rates using the rate base method result in a smaller Operating Income than that recently approved for Granite, even though Chino's expenses are nearly five times those of Granite.

	Granite	Chino Meadows		
	Mountain	Staff Position	Company Filing	
	Rate Decision	RB Method	RB Method	OM Method
Revenue	\$ 110,575	\$ 330,067	\$ 373,940	\$ 415,938
Operating Expenses	77,959	310,254	353,507	363,946
Operating Income	\$ 32,616	\$ 19,813	\$ 20,433	\$ 51,992
Return on Rate Base	10.00%	9.60%	9.60%	24.39%
Operating Margin	29.50%	6.00%	5.50%	12.50%

In addition, I researched Class C companies with rate filings made in 2009 and 2010. The table below summarizes my findings from those cases.

Companies without Rate Base - Rate Set Based on Cash Flow Analysis			
Utility	Docket	Rate Base	Operating Margin
Valle Verde	W-01431A-09-0360	(593,061)	10.1%
Companies with Rate Base - Rate Set Based on Rate of Return			
Utility	Docket	Rate Base	Operating Margin
Southland Utilities	W-02062A-09-0515	417,978	16.9%
Mt. Tipton Water	W-02105A-09-0522	569,669	13.5%
Las Quinta Serenas	W-01583A-09-0589	1,913,221	25.5%
Abra Water	W-01782A-10-0224	466,276	11.1%
Average		841,786	16.8%

1 **Q. HOW DOES CHINO'S RATE BASE COMPARE TO THE COMPANIES IN**
2 **YOUR TABLE THAT HAD RATES SET BASED ON RATE OF RETURN?**

3 A. Chino has a much smaller rate base than the other companies. Chino's rate base is about
4 $\frac{1}{2}$ the level of the smallest rate base and approximately 25% of the average rate base of
5 the companies.

6 **Q. WHAT CONCLUSIONS HAVE YOU DRAWN AFTER COMPARING THE**
7 **SAMPLE COMPANIES TO CHINO?**

8 A. It is clear that setting rates using the rate-base method for water companies with a small
9 rate base results in a much lower operating margin. In the case of Chino, the operating
10 margin would be in the 5% to 6% range, with the companies with larger rate bases
11 averaging 16.8%. It is also clear that Staff's approach works to the detriment of Chino, a
12 company with a small rate base, as compared to a company with no rate base at all. Put
13 another way, Chino would have received higher rates if it had not invested in facilities.
14 As applied to smaller utilities, Staff's method favors utilities that don't invest over those
15 that do.

16 The underlying question at issue is: what level of resulting operating margin should the
17 transition from rate of return ratemaking to operating margin ratemaking be made?

18 **Q. HAVE OTHER JURISDICTIONS ADDRESSED THE ISSUE?**

19 A. I am aware that the California Public Utilities Commission ("CPUC") has adopted
20 WATER DIVISION STANDARD PRACTICE U-3-SM (SP-U-3-SM) requiring the
21 CUPC to apply standard rates of return and standard rates of margin for water companies
22 with less than 2,000 customers (Class C and Class D). Pursuant to the Standard Practice
23 the CUPC bases its revenue requirement on the method that produces the *highest* revenue

1 requirement². CPUC Staff currently recommends a 23.4% rate of margin for Class C
2 water utilities (501 – 2000 customers).

3 **Q. HOW WOULD THIS POLICY APPLY IN ARIZONA?**

4 A. If this policy was used here, whenever a small water company's operating margin
5 dropped below the operating margin typical for larger companies, ratemaking would
6 transition from a rate-of-return basis to an operating-margin basis. Based on my analysis
7 of larger Class C companies, operating margin ratemaking would be used for Chino.

8 **Q. ARE YOU AWARE OF ANY CLASS C OR LARGER COMPANIES WITH RATE**
9 **BASE RECENTLY AFFORDED OPERATING MARGIN RATEMEKING**
10 **TREATMENT?**

11 A. Johnson Utilities Wastewater Division recently had rates set on an operating margin
12 basis.³ Since Johnson had a rate base of only \$136,562, Staff recommended setting rates
13 on an operating margin of 10.0%. The Commission ultimately approved a 3.0%
14 operating margin for Johnson, which produced operating income of \$290,610 and cash
15 flow of approximately \$2.4 million. The available cash flow represented 25.2% of
16 expenses.

17 **Q. BASED ON YOUR REVIEW OF OTHER CLASS C COMPANIES, THE CPUC**
18 **STANDARD PRACTICE AND THE JOHNSON UTILITIES CASE, DO YOU**
19 **BELIEVE THAT CHINO'S REVENUE REQUIREMENT SHOULD BE SET**
20 **USING AN OPERATING MARGIN?**

21 A. Yes. Chino should not be discriminated against compared to similarly situated
22 companies with no rate base or larger companies with or without a rate base. It is unfair

² See CPUC STANDARD PRACTICE FOR PREPARING RESULTS OF OPERATION REPORTS FOR
GENERAL RATE INCREASE REQUESTS OF WATER UTILITIES OTHER THAN MAJOR COMPANIES
Standard Practice U-3-SM revised April 2006 and CPUC RESOLUTION NO. W-4524, dated March 17, 2005.

³ See Decision No. 71854 in Docket No. WS-02987A-08-0180

1 for Staff to recommend a 10% operating margin for Johnson Utilities and refuse to
2 recommend an operating margin approach in this case.

3 **Q. WHAT OPERATING MARGIN ARE YOU RECOMMENDING IN YOUR**
4 **REJOINDER TESTIMONY?**

5 A. I am recommending an operating margin of 12.5%. The operating margin was selected to
6 produce a ratio of cash flow to expenses of 25%, approximately equaling the ratio
7 granted in the Johnson Utilities case.

8 **IV RATE BASE**

9 **Q. HAS THE COMPANY UPDATED ITS RATE BASE POSITION?**

10 A. No. Although I have not yet reviewed Staff's schedules, I expect Staff to adopt the
11 adjustments proposed in my rebuttal testimony and that our rate base amounts will
12 substantially agree.

13 **V INCOME STATEMENT**

14 **Q. PLEASE SUMMARIZE THE COMPANY'S REJOINDER POSITION**
15 **REGARDING REVENUE AND EXPENSES SHOWN ON SCHEDULES RLJ-11**
16 **AND RLJ-12?**

17 A. The Company does not propose any adjustments to revenue and agrees with test year
18 revenue of 351,633 as proposed by Staff. The Company's proposed adjustments to
19 expenses result in test year expenses of \$363,946.

20 **Q. WHAT ARE THE REMAINING AREAS OF DISAGREEMENT BETWEEN**
21 **STAFF AND THE COMPANY?**

22 A. The primary areas of disagreement are related to salaries and wages expenses, treatment
23 of the cost of employee meals and the *pro forma* adjustment for proposed leak detection
24 services. There are also minor agreements regarding the allocation of certain expenses
25 between Chino and Granite Mountain.

1 **Q. IS THE COMPANY ALTERING ITS POSTION ON ANY OF THE DISPUTED**
2 **ITEMS?**

3 A. No. The Company stands by its Rebuttal Testimony on disputed issues.

4 **Q. WHAT IS THE NATURE OF YOUR DISAGREEMENTS WITH STAFF?**

5 A. The disagreements are largely related to what adjustments should be made to establish a
6 normal or more realistic relationship between revenues expenses and rate base. Staff's
7 customer-centric approach is focused on making adjustments that tend to lower the
8 revenue requirement. My approach is more focused on making sure Chino has the
9 resources necessary to attract capital and continue making improvements to its system.

10 For example, Staff reaches back into 2008 to establish an allocation for salaries charged
11 to Granite. Staff argues that using a different salary allocation than used in the 2008
12 Granite case will result in the Granite customers overpaying. Yet Staff allocates
13 transportation and insurance expense to Granite even though none was allocated in the
14 Granite case. Using Staff's logic, wouldn't that cause Granite customers to underpay and
15 the utility to be shorted? The only consistency in Staff's positions is that both actions
16 lower Chino's revenue requirement.

17 Another example is Staff's three-year averaging of Chino's overtime expense while
18 failing to normalize \$30,000 in expenses for repairs to its water system incurred in 2008.
19 It seems only fair that Staff normalize all of the expenses or at least provide an operating
20 margin that provides sufficient cash flow to deal with unexpected expenses while
21 maintaining sufficient income to attract new capital.

22 More troubling to me are Staff's water management recommendations that will reduce
23 Chino's revenues and increase Chino costs. I have no problem with conservation
24 oriented rates and Best Management Practices. However, at the same time Staff is

1 recommending a mere 6.0% for operating margin, Staff provides no adjustment⁴ to deal
2 with the certainty that Chino will experience a reduced level of operating income as a
3 result of the water management recommendations.

4 **Q. ARE THE COMPANY AND STAFF IN AGREEMENT REGARDING RATE**
5 **CASE EXPENSE?**

6 A. I don't know. Staff states that it requested invoices to support the requested \$30,000 in
7 rate case expense. Chino has provided the invoices for rate case expense incurred to date.
8 Those invoices total only about \$5,000. Those invoices do not include the costs for my
9 preparation of Rebuttal Testimony and Rejoinder Testimony, my preparation for hearing,
10 my appearance at hearing or any post-hearing activities. Likewise they do not include
11 the costs for Craig A. Marks PLC for legal services pertaining to the review and filing of
12 testimony, preparation for hearing, appearance at hearing and any post-hearing activities.
13 That is because these activities have not yet been billed to Chino. The costs for my
14 services and the services of Craig A. Marks PLC are estimated at \$25,000. The requested
15 rate case expense consists of these estimated costs plus the actual costs incurred to date.

16 **Q. HOW DO THESE COSTS COMPARE TO OTHER CLASS C COMPANY'S**
17 **RATE CASE EXPENSE?**

18 A. They compare favorably. When researching Class C companies with rate filings made in
19 2009 and 2010, I noted the approved rate case expense. It ranged from a high of \$80,000
20 to a low of \$7,500 with an average of \$39,643.

21 **Q. WHAT AMORTIZATION PERIOD DOES THE COMPANY PROPOSE?**

22 A. My review indicated that the Commission approved an amortization period of three years
23 for all of the reviewed Class C companies. The Company believes a three year

⁴ Staff's specifically rejects the Company's *pro forma* adjustment of \$2,296 for leak detection services.

1 amortization period is appropriate, since the Company is likely to need to file for another
2 rate increase within three years.

3 **Q. WHAT IS THE RESULTING RATE CASE EXPENSE RECOMMENDED BY**
4 **THE COMPANY?**

5 A. As shown on Schedule RLJ-20, the resulting rate case expense is \$10,000 per year.

6 **VI OTHER ISSUES**

7 **Q. YOU HAVE MENTIONED CHINO'S DESIRE TO CONTINUE MAKING**
8 **IMPROVEMENTS TO ITS SYSTEM. CAN YOU EXPAND ON THIS**
9 **STATEMENT?**

10 A. Yes. Since Matt Lauterbach was hired in August of 2008, Chino (and Granite) has
11 embarked taken on multiple efforts to improve their operations and physical water
12 systems. A summary of improvement activities is attached as Exhibit A. Chino believes
13 that adoption of Staff's recommendations in this case will impair their efforts to improve
14 operations and attract capital needed for additional improvements.

15 **Q. ARE THERE ANY OTHER ISSUES YOU WOULD LIKE TO DISCUSS?**

16 A. We still have not received Staff's rebuttal schedules. Once I review those, I may need to
17 file supplemental rejoinder testimony.

18 **VII RATE DESIGN**

19 **Q. HAS THE COMPANY PROVIDED AN UPDATED RATE DESIGN WITH ITS**
20 **REBUTTAL TESTIMONY?**

21 A. No. The Company will present a late filed rate design once it has had the opportunity to
22 review Staff's surrebuttal schedules.

23 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

24 A. Yes.

SCHEDULES

RLJ-1 – RLJ-27

n of Increase in Gross Revenue Requirements

	Company As Filed	Company Rebuttal RB Method	Company Rebuttal OM Method
<u>Rate Base Method</u>			
Adjusted Original Cost Rate Base	\$ 225,397	\$ 213,154	
Adjusted Operating Income	(2,278)	\$ 3,044	
Current Rate of Return	-1.01%	1.43%	
Required Rate of Return	10.81%	9.60%	
Required Operating Income	\$ 82,318	\$ 20,463	
Operating Income Deficiency (Rate Base Method)	\$ 88,912	\$ 17,419	
Gross Revenue Conversion Factor	1.3699	1.2806	
Increase in Gross Revenue	\$ 84,641	\$ 22,307	
Adjusted Test Year Revenue	\$ 351,633	\$ 351,633	
Proposed Annual Revenue	\$ 436,274	\$ 373,940	
Required Increase/(Decrease in Revenue) (%)	24.07%	6.34%	
<u>Operating Margin Method</u>			
Current Operating Margin			0.8
Adjusted Operating Income		\$ 3,044	
Required Operating Margin			12.5
Required Operating Income		\$ 51,900	
Operating Income Deficiency (Operating Margin Method)		\$ 48,856	
Gross Revenue Conversion Factor			1.31
Increase in Gross Revenue		\$ 64,300	
Adjusted Test Year Revenue		\$ 351,633	
Proposed Annual Revenue		\$ 415,933	
Required Increase/(Decrease in Revenue) (%)			18.2

Calculation of Effective Tax Rate

Operating Income Before Taxes	100.0000%	
State Tax Rate	6.9680%	
Federal Taxable Income	93.0320%	
Applicable Federal Tax Rate	17.1424%	
Effective Federal Tax Rate	15.9479%	
Combined Effective Tax Rate		22.9159%

Calculation of Effective Property Tax Rate

Unity	100.0000%	
Combined Effective Tax Rate	22.9159%	
One Minus Combined Effective Tax Rate	77.0841%	
Property Tax Factor	1.2530%	
Effective Property Tax Factor		0.9659%
Federal and State Income Tax Rate and Property Tax Rate		23.8818%

Calculation of Gross Revenue Conversion Factor

Revenue	100.0000%
Combined Tax and Property Tax Rate	23.8818%
Operating Income Percentage	76.1182%
Gross Revenue Conversion Factor	1.31375

Original Cost Rate Base Elements

	Company As Filed	Company Rebuttal
oss Utility Plant in Service	\$ 761,698	\$ 765,198
is: Accumulated Depreciation	508,828	508,828
t Utility Plant in Service	<u>\$ 252,870</u>	<u>\$ 256,370</u>
is:		
ances in Aid of Construction	\$ 19,004	\$ 7,829
vice Line and Meter Advances	42,208	42,208
ntributions in Aid of Construction (CIAC)	12,809	23,984
less: Accumulated Amortization of CIAC	<u>2,631</u>	<u>2,910</u>
Net CIAC	\$ 10,178	\$ 21,074
al Advances and Contributions	\$ 71,390	\$ 71,111
stomer Security Deposits	\$ -	\$ 11,330
umulated Deferred Income Taxes	\$ -	\$ -
S:		
orking Capital Allowance	\$ 37,764	\$ 33,072
aterials and Supplies Inventories	\$ 3,024	\$ 3,024
epayments	\$ 3,129	\$ 3,129
te Base	\$ 225,397	\$ 213,154

ervice	\$ 252,870	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
onstruction	19,004	(11,175)					
er Advances	42,208						
of Construction (CIAC)	12,809		11,175				
Amortization of CIAC	2,631			279			
	10,178	-	11,175	(279)	-	-	
Contributions	71,390	(11,175)	11,175	(279)	-	-	
deposits	-				11,330		
ed Income Taxes	-						
ance	37,764					\$ (4,692)	
es Inventories	3,024						
	3,129						
	225,397	11,175	(11,175)	279	(11,330)	(4,692)	

Just AIAC Balance to Reflect Expired Main Extension Agreements

<u>description</u>	<u>Company As Filed</u>	<u>Company Adjustment</u>	<u>Company Adjusted Balance</u>
AIAC - Main Extension Contracts	\$ 19,004	\$ (11,175)	\$ 7,829

<u>Expiring Contracts</u>	<u>Contract Balance 12/31/2009</u>
Allen Barras (6/8/1999)	1,144
Hoffman (9/16/1999)	2,626
Vivien & Sebastien Garote (10/28/1999)	926
Herb Schuerman (12/15/1999)	2,453
Lyle Garrison (12/20/1999)	4,026
	<u>11,175</u>

Just CIAC Balance to Reflect Expired Main Extension Agreements

<u>description</u>	<u>Company As Filed</u>	<u>Company Adjustment</u>	<u>Company Adjusted Balance</u>
Loss CIAC	\$ 12,809	\$ 11,175	\$ 23,984

Just Amortization of CIAC

Description

Amortization of CIAC - As Filed
Amortization of CIAC - Additions

	Company As Filed	Company Adjustment	Company Adjusted Balance
Amortization of CIAC - As Filed	\$ 2,631	\$ -	\$ 2,631
Amortization of CIAC - Additions	-	279	279
	<u>\$ 2,631</u>	<u>\$ 279</u>	<u>\$ 2,910</u>

Calculation of Amortization of CIAC

CIAC Amortization Rate	2.50% (5.0% x 1/2 year)
CIAC Additions	<u>\$ 11,175</u>
Amortization of CIAC	\$ 279

cept Staff Rate Base Adjustment No. 4 - Customer Deposits

<u>scription</u>	Company <u>As Filed</u>	Company <u>Adjustment</u>	Company Adjusted <u>Balance</u>	
stomer Deposits	\$ -	\$ 11,330	\$ 11,330	Accept Staff Adjustn

Adjustment to Reflect Cash Working Capital

<u>Description</u>	<u>Company As Filed</u>	<u>Company Adjustment</u>	<u>Company Adjusted Balance</u>
Cash Working Capital	\$ 37,764	\$ (4,692)	\$ 33,072
Operation and Maintenance Expense			\$ 348,589
Less			
Depreciation			39,029
Taxes			29,815
Purchased Power			22,657
Purchased Water			100
Net Operation and Maintenance Expense			\$ 256,988
Multiplied by			<u>1/8</u>
			\$ 32,124
Purchased Power and Purchased Water			\$ 22,757
Multiplied by			<u>1/24</u>
			\$ 948
Total Cash Working Capital			\$ 33,072

Adjustment to Reflect Post-Test Year Plant

<u>Description</u>	<u>Company As Filed</u>	<u>Company Adjustment</u>	<u>Company Adjusted Balance</u>
Plant In Service	\$ -	\$ 3,500.00	\$ 3,500.00
4/5/2010 Caselle Clarity Upgrade Payment		\$ 688	
8/17/2010 Caselle Clarity Final Upgrade Payment		688	
8/17/2010 Caselle Cash Receipts Module		<u>2,125</u>	
		\$ 3,500	

Income Method

	Company Test Year Ended <u>12/31/2009</u>	Company <u>Adjustments</u>	Company Test Year as <u>Adjusted</u>	Company Proposed <u>Increase</u>	Comp With I <u>Incre</u>
Revenues					
Metered Water Revenues	\$ 344,260	\$ -	\$ 344,260	\$ 64,305	\$ 408,565
Other Water Revenues	7,373	-	7,373		
Total Revenues	<u>\$ 351,633</u>	<u>\$ -</u>	<u>\$ 351,633</u>	<u>\$ 64,305</u>	<u>\$ 415,938</u>
Operating Expenses					
Salaries and Wages - Employees	\$ 126,312	\$ (8,809)	\$ 117,503		\$ 117,503
Salaries and Wages - Officers, Dir., Stockholder	35,498	-	35,498		
Purchased Water	100	-	100		
Purchased Power	22,657	-	22,657		
Chemicals	884	-	884		
Materials & Supplies & Repairs & Maintenance	16,148	-	16,148		
Office Supplies Expense	17,050	-	17,050		
Contract Servcies Engineering	-	-	-		
Contract Services Accounting	600	-	600		
Contract Servcies Legal	3,995	(2,995)	1,000		
Contract Servcies Testing	7,062	(2,296)	4,766		
Contract Servcies Other	9,263	2,296	11,559		
Rents	6,000	-	6,000		
Equipment Rental	246	-	246		
Transportation Expense	15,726	(1,582)	14,144		
Insurance - General Liability	11,848	(3,035)	8,813		
Insurance - Worker's Compensation	2,555	-	2,555		
Insurance - Other	165	-	165		
System Support	4,339	(1,463)	2,876		
Regulatory Expense	442	9,558	10,000		
Bad Debt Expense	1,356	-	1,356		
Miscellaneous Expense	4,089	(1,854)	2,235		
Licensing & Permits	2,910	-	2,910		
Tax - Other	6,446	-	6,446		
Property Taxes	22,329	(10,142)	12,187	806	
Payroll Taxes	10,804	(428)	10,376		
Depreciation Expense	25,132	13,897	39,029		
Interest on Deposits	-	680	680		
Operating Expenses Before Income Taxes	<u>\$ 353,956</u>	<u>\$ (6,173)</u>	<u>\$ 347,783</u>	<u>\$ 806</u>	<u>\$ 348,589</u>
Income Taxes	(45)	850	805	14,552	
Total Operating Expenses	<u>\$ 353,911</u>	<u>\$ (5,322)</u>	<u>\$ 348,589</u>	<u>\$ 15,357</u>	<u>\$ 363,946</u>
Operating Income (Loss)	<u>\$ (2,278)</u>	<u>\$ 5,322</u>	<u>\$ 3,044</u>	<u>\$ 48,948</u>	<u>\$ 51,992</u>

Operating Margin

	100								
	22,657								
	884								
& Repairs & Maintenance	16,148								
se	17,050								
ineering	-								
ounting	600								
al	3,995			(2,995)					
ting	7,062					(2,296)			
er	9,263								
	6,000								
	246								
se	15,726							(1,582)	
iability	11,848								
Compensation	2,555								
	165								
	4,339								
	442								
	1,356								
se	4,089								
	2,910								
	6,446								
	22,329								
	10,804							0%	
	25,132								
	-								
e Income Taxes	\$ 353,956	\$ (8,809)	\$ -	\$ (2,995)	\$ (2,296)	\$ (1,582)	\$		
	(45)								
as	\$ 353,911	\$ (8,809)	\$ -	\$ (2,995)	\$ (2,296)	\$ (1,582)	\$		
)	\$ (2,278)	\$ 8,809	\$ -	\$ 2,995	\$ 2,296	\$ 1,582	\$		

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liability
Compensation

9,558

se (1,854)

(10,142)

(428)

13,897

e Income Taxes

\$	9,558	\$	(1,854)	\$	(10,142)	\$	(428)	\$	13,897	\$	-	\$	2,296
												850	
\$	9,558	\$	(1,854)	\$	(10,142)	\$	(428)	\$	13,897	\$	850	\$	2,296
\$	(9,558)	\$	1,854	\$	10,142	\$	428	\$	(13,897)	\$	(850)	\$	(2,296)

Salaries and Wages - Employees

<u>Description</u>	<u>Company As Filed</u>	<u>Company Adjustment</u>	<u>Company Adjusted Balance</u>
Salaries and Wages - Employees	\$ 126,312	\$ (8,809)	\$ 117,503

<u>Salaries and Wages Adjustment</u>			
To remove salaries and wages chargeable to Granite Mountain	\$	(5,248)	Chino Payroll Records
To normalize overtime charges	\$	(2,761)	Per Staff Direct
To remove 50% of bonuses	\$	(800)	1/2 G/L acct. No. 6601.00
	\$	(8,809)	

Salary and Wages - Officers, Directors, Stockholder

<u>Description</u>	Company <u>As Filed</u>	Company <u>Adjustment</u>	Company Adjusted <u>Balance</u>
Salary and Wages - Officers, Directors, Stockholder	\$ 35,498.00	\$ -	\$ 35,498.00

Contract Services - Legal

<u>Description</u>	Company <u>As Filed</u>	Company <u>Adjustment</u>	Company <u>Adjusted Balance</u>	
Contract Services - Legal	\$ 3,995	\$ (2,995)	\$ 1,000	Accept Staff Adjustment

Contract Servcies - Testing

<u>Description</u>	Company <u>As Filed</u>	Company <u>Adjustment</u>	Company <u>Adjusted Balance</u>	
Contract Servcies - Testing	\$ 7,062	\$ (2,296)	\$ 4,766	Accept Staff Adjustment

Transportation Expense

<u>Description</u>	Company <u>As Filed</u>	Company <u>Adjustment</u>	Company Adjusted <u>Balance</u>	
Transportation Expense	\$ 15,726	\$ (1,582)	\$ 14,144	Accept Staff Adjustment

Insurance, General Liability

<u>Description</u>	<u>Company As Filed</u>	<u>Company Adjustment</u>	<u>Company Adjusted Balance</u>
Insurance, General Liability	\$ 11,848	\$ (3,035)	\$ 8,813

Insurance, General Liability Expense			
	Amount		
	Before Allocation	Allocation Percentage	Allocated Amount
Chino Meadows	11,848	0.7439	8,813
Granite Mountain	11,848	0.2561	3,035

Calculation of Three-Factor Allocation					
	Number of Customers	Plant In Service	O & M Expense	Total	Allocation Percentage
Chino Meadows	0.8994	0.5150	0.8172	2.2316	
Granite Mountain	0.1006	0.4850	0.1828	0.7684	
	1.0000	1.0000	1.0000	3.0000	

Allocation Factors			
	Chino Meadows	Granite Mountain	Total
Customers	876 0.8994	98 0.1006	974 1.0000
Plant In Service	\$ 765,198 0.5150	\$ 720,673 0.4850	\$ 1,485,871 1.0000
O&M Expense	\$ 348,589 0.8172	\$ 77,959 0.1828	\$ 426,548 1.0000

ystem Support

<u>Description</u>	Company <u>As Filed</u>	Company <u>Adjustment</u>	Company Adjusted <u>Balance</u>	
ystem Support	\$ 4,339	\$ (1,463)	\$ 2,856	Accept Staff Adjustment

Rate Case Expense

<u>Description</u>	Company <u>As Filed</u>	Company <u>Adjustment</u>	Company Adjusted <u>Balance</u>
Rate Case Expense	\$ 442	\$ 9,558	\$ 10,000
Rate Case Expense		\$ 30,000	
Years		<u>3</u>	
Expense		\$ 10,000	

Miscellaneous Expense

<u>Description</u>	Company <u>As Filed</u>	Company <u>Adjustment</u>	Company Adjusted <u>Balance</u>
Miscellaneous Expense	\$ 4,089.00	\$ (1,854)	\$ 2,235
Out of Test Year Expense (Payment on old bank debt)			\$ 1,237
Meals at administrative meetings			617
			<u>\$ 1,854</u>

Property Tax Expense

<u>Description</u>	<u>Company As Adjusted</u>	<u>Company Proposed</u>
Adjusted Revenues in year ended 12/31/09	\$ 351,633	\$ 351,633
Adjusted Revenues in year ended 12/31/09	351,633	351,633
Adjusted Revenues in year ended 12/31/09	351,633	
Proposed Revenues after Increase		415,938
Average of three year's of revenue	351,633	373,068
Average of three year's of revenue, times 2	703,266	746,136
Add:		
Construction Work In Progress at 10%	-	-
Deduct:		
Net Book Value of Transportation Equipment	54,837	54,837
Full Cash Value	648,429	691,299
Assessment Ratio	21.0%	21.0%
Assessed Value	136,170	145,173
Property Tax Rate (Test Year)	8.9500%	8.9500%
Adjusted Test Year Property Tax	\$ 12,187	
Company Proposed Property Tax	22,329	
Test Year Adjustment	\$ (10,142)	
Property Tax at Proposed Rates		\$ 12,993
Adjusted Test Year Property Tax		12,187
Increase in Property Tax due to Rate Increase		\$ 806
Increase to Property Tax Expense		\$ 806
Increase in Revenue Requirement		\$ 64,305
Increase to Property Tax per Dollar Increase in Revenue		1.2530%

Payroll Taxes

<u>Description</u>	Company <u>As Filed</u>	Company <u>Adjustment</u>	Company Adjusted <u>Balance</u>
Payroll Taxes	\$ 22,329	\$ (428)	\$ 21,901

Depreciation Expense

<u>Description</u>	<u>Company As Filed</u>	<u>Company Adjustment</u>	<u>Company Adjusted Balance</u>
Depreciation Expense	\$ 25,132	\$ 13,897	\$ 39,029
Composite Depreciation Rate		7.96%	From Staff Income Adjustment 12
CIAC	\$	23,984	Schedule RLJ-6
Amortization of CIAC	\$	1,909	
Depreciation Expense Before Amortization of CIAC	\$	40,938	From Staff Income Adjustment 12
Less Amortization of CIAC	\$	1,909	
Test Year Depreciation Expense	\$	39,029	
Depreciation Expense as Filed		25,132	
Company's Adjustment	\$	13,897	

Income Tax Expense

<u>Description</u>	<u>Company As Filed</u>	<u>Company Adjustment</u>	<u>Company Adjusted Balance</u>
Income Tax Expense	\$ (45)	\$ 850	\$ 805

	<u>Adjusted Test Year</u>	<u>Proposed with Increase</u>
<i>Calculation of Income Tax:</i>		
Revenue	\$ 351,633	\$ 415,938
Less: Operating Expenses - Excluding Income Taxes	347,783	348,589
Less: Synchronized Interest	-	-
Arizona Taxable Income	\$ 3,850	\$ 67,349
Arizona State Income Tax Rate	6.9680%	6.9680%
Arizona Income Tax	\$ 268	\$ 4,693
Federal Taxable Income	\$ 3,582	\$ 62,656
Federal Tax on First Income Bracket (\$1 - \$50,000) @ 15%	537	7,500
Federal Tax on Second Income Bracket (\$50,001 - 75,000) @ 25%	-	3,164
Federal Tax on Third Income Bracket (\$75,001 - 100,000) @ 34%	-	-
Total Federal Income Tax	537	10,664
Combined Federal and State Income Tax	<u>\$ 805</u>	<u>\$ 15,357</u>
Effective Federal Income Tax Rate	15.0000%	17.0200%
Applicable Federal Income Tax Rate (Rate Applicable to Revenue Increase)		17.1424%

Leak Detection Expense

<u>Description</u>	Company <u>As Filed</u>	Company <u>Adjustment</u>	Company Adjusted <u>Balance</u>
Contract Servcies - Other	\$ -	\$ 2,296	\$ 2,296

Interest on Deposits

<u>Description</u>	<u>Company As Filed</u>	<u>Company Adjustment</u>	<u>Company Adjusted Balance</u>
Interest on Deposits	\$ -	\$ 680	\$ 680

Test Year Deposit Balance	\$ 11,330
Interest Rate	6.00%
Annual Interest Expense	\$ 680

EXHIBIT A

Chino Meadows II
Summary of Completed and Planned
Operational and System Improvements
[Starting August 2008]

Operational Improvements

- The Company's accounting software was convoluted and did not fully comply with the NARUC Chart of Accounts. A temporarily employed water administrator had decided to reformat the Chart of Accounts to a non-standard format. Staff has spent an extensive amount of time correcting the system which now complies with the NARUC Chart of Accounts.
- The company was historically technologically impaired and did not offer modern day conveniences, such as water company websites, digital applications, payment options for debit/credit cards, etc. Now new customers can visit our website at www.cmiiwc.com to obtain an application, see a map of the water system, view the annual water quality reports, get emergency contact phone numbers, find links the AZ Corporation Commission, ADWR, ADEQ or even pay their bill online.
- The company had nearly a hundred copies of old engineering maps of different section additions or changes to the system. These copies were compiled into a hand drawn map. Our field technicians were using educated guess as to the locations of the water mains underground, as some of the water lines are greater than 30 years old.

A project to get accurate GPS locations on every system component we could locate in our system has been completed, including using GIS technology to build an interactive map. This new map incorporates a satellite image and shows the location of mains, meters, valves, well, storage tanks, blow offs, air release valves, etc. It also shows notes from field technicians about the depths of pipes and other pertinent information. Additionally it has a feature to see actual photographs from previous repairs and excavations, so future employees can know what to expect if a future need arises to excavate.

- The company's software system from Caselle was antiquated and support from the company was about to be terminated. In 2010 we purchased the upgrade Caselle Clarity to better serve the company and the customers. The addition of the cash receipting module allows for customers debit/credit card payments to be brought into the system automatically on a daily basis. It also enables our customers to go online and see the current and previous balances and usage.
- In 2009 the company changed it's billing format from a post card bill to a professional style 8 ½ x 11 format which includes a perforated remittance slip, a return envelope, custom messages for customers, and a graph to show the customers usage over the last year.

Chino Meadows II

Summary of Completed and Planned Operational and System Improvements

System Improvements

- Between September 2008 and December 2010 Chino Meadows Water had approximately 8 water main breaks which caused water service to be shut off to 125 households in order to repair the main. This affected so many customers because this was the only main providing service to these homes due to the terrain and washes surrounding the area. In 2010 we installed an 800 foot extension of the water main through a wash in order to loop the system at a cost of \$36,353. A subsequent shut off caused only 15 homes to be offline instead of 125 thanks to the extension. In addition to the benefit of reduced impact to customers, the extension reduces the pressure on the section where these 8 incidents occurred. This section of piping is one of the lowest elevations in the system and the piping is approximately 30-40 years old.
- The company has many, many different types and ages of water meters in the system. In March 2010 purchase of (90) 5/8x3/4" meters was authorized to replace old ones in the system, with the hopes that it would improve our water loss ratios. We would like to replace all of the meters in the system at a rate of 10% or 90 units each year over the next 9 years. The total estimated costs for that, including the 90 we purchased in 2010, would be about \$37,800.
- In March 2011 we purchased a used 40kw Portable Backup Generator capable of supplying power to one of our well and storage tank facilities and we completed the subsequent electrical work to make it functional. Since March we have provided water service on at least three occasions of power outages, where it would not have been possible without the backup generator.
- The company would like to have backup generators and electrical work for the additional well location on Donna Dr. and the additional storage tank/pressure tank location on Cactus Wren Rd. The estimated costs for the required generators are approximately \$6k to \$10k each and the bid on the electrical work is \$4199.49 for each of the two locations.
- Our service trucks are a 1999 and a 2000 light duty Ford Ranger with an excessive amount of miles on them. These trucks are scheduled for replacement.
- There are 4 areas within the distribution system that should have main extensions in order to "loop" the system and ensure continuous water service for customers. We have not received estimates on the cost of these improvements.
- The water system has incurred 8 additional leaks and breaks in the last 6 months due to aging pipes, tree roots and inadequate materials used in the original construction. The repairs for these issues are expensed but they are the direct cause of an aging system with an extensive amount of tree roots reaching and breaking the pipes due to the root balls that attack the pipes and exploit the leaks in the system. This is another reason why the company needs to pursue leak detection services, to proactively repair the leaks before the line breaks and forces water outages.